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CONTROL OF RAILROAD ACCOUNTS IN LEADING EUROPEAN COUNTRIES

SUMMARY

Manner and extent of supervision largely gauged by the character of the government, 471 — Accounting methods of the German railroads, 472 — Defects, 473 — Policy of the British government, 474. — Published statistics give little information in regard to operating costs of the net return on capital investment, 477. — Prescribed accounts fall into two groups, those relating to Capital and those relating to Revenue, 479. — Objections to the "Double Account," 480. — Form of the general balance sheet unsatisfactory, 482 — Chief defect in British accounting methods that they fail to distinguish properly between capital and revenue expenditure, 485 — Railroad policy of France, 489 — Close financial bonds existing between railroads and government, 490 — Prescribed accounts, 490. — Auditing commission, 496 — Preventive control exercised by consultative committee, 497.

THE great power over railway accounts given to the Interstate Commerce Commission by the Act of 1906¹ gives interest to the action of foreign governments in the same direction. It is proposed in this article to review their legislation and its significance.

The manner as well as the extent of supervision in each country, is largely gauged by the character of the government and the public attitude toward private operation of public utilities. In Germany, the trend of governmental activities has resulted in virtual monopoly of transportation by the state. In Great Britain, on the other hand, private initiative

¹ See the articles in this Journal by Professor H. C. Adams, *Administrative Supervision of Railways under the Twentieth Section of the Act to regulate Commerce*, vol. xxii, no. 3, pp. 364-383 and by Professor F. H. Dixon, *Railroads in their Corporate Relations*, vol. xxiii, no. 1, pp. 34-65.

has been encouraged and assisted. The outcome has been as little interference in the internal workings of the railroads as is thought consistent with preservation of public interests. France occupies a middle ground between Germany and Great Britain. Altho the important French railroad systems were built and operated as private undertakings, the State has been closely identified and associated with them, not only in the planning and in the construction of the systems, but also in matters involving financial responsibility. The interests of the French government in the great railroad systems necessitate, in fact, an even stricter control and supervision of accounts than if the lines were owned and operated directly by the state.

GERMANY

The accounting methods of the state-owned railroads in Germany require very little comment. The receipts and expenditures of the railroads form a part of the general state budget. Accordingly, the unsatisfactory and inadequate budgetary system of accounting prevails in the German railroads. Double entry bookkeeping, whereby accounts of capital investment are separated from revenue or operating accounts, and income and expense distinguished from receipts and disbursements, finds no place in the German state-owned railroads. Consequently, the chief aim of commercial accounting, — a perfect exhibit of the true financial status and the operating results, — is completely ignored. Government accounting on the "budgetary system" records the "de facto" rather than the "de jure" aspect of financial transactions. The accounts consist merely of schedules giving cash receipts and disbursements, without

reference to the division between capital and revenue. When the system, as applied to railroads in Germany, is followed out in detail, each branch or department has the amount of its expenditures during a fixed period limited by legal appropriation.¹ It thus becomes necessary to create a compensating fund, out of which excess expenditures in each department can be met until means of covering the deficiency in that department can be provided.²

This method is ill adapted to railroad accounts. The most valuable features of modern accounting have their highest development and greatest usefulness in railroad operations. The accurate classification of details; the combination of all departmental transactions under the two main categories of capital and revenue, without destroying the identity or effacing the operating results of each department; and the summarization of related periodical returns, — are required with greater exactness for railroads than for other enterprises. If the state undertakes a business enterprise, its accounting should not be inferior to that of private undertakings. Its bookkeeping should follow the double-entry system, with a balance sheet of the assets and the liabilities and an income sheet for the financial results of operation. The attainment of this end necessitates the separation of the accounts, in every detail, from the accounts of the fiscal operations of the state. The influence of state ownership, moreover, should not affect in the slightest degree the statement of the net return on the investment.³

¹ See *Transportation and Traffic in Germany*, by Logan G. McPherson, *Railway Age Gazette*, Jan 21, 1910, vol. lxxviii, p. 145.

² In order to cover excesses of credits for the variable expenses of a department by means of the receipts for the corresponding financial period, there is generally turned into the "compensating fund," when the accounts for the period are closed, certain balances from other departments or branches.

³ See *Proceedings of the 7th International Railway Congress*, 1905, Question xiv, pp. 3-24, and pp. 212-214.

GREAT BRITAIN

Great Britain furnishes an example of private initiative and private operation. The policy of the British government in the regulation and control of railways is based largely on expediency, coupled with the English respect for vested right in the profits from business organization. Matters which affect the public directly, such as, for example, railway rates and safety devices, have been, almost from the first, subjected to the close supervision and control of Parliament; but the financial and accounting operations of the companies have been comparatively free from Parliamentary interference. This policy in Great Britain has been influenced by the belief — especially during the early period of railroad building — that undue interference in financial affairs tends to discourage investment.

The first legislation in Great Britain which can be said directly to concern railroad accounts was the Railway Companies' Act of 1867 (30 & 31 Vict. 127). The railroads at that time were in sore financial straits. A Parliamentary Commission had been appointed to inquire into their financial operations. This commission, fearing to discourage investment, recommended that railroad regulation should be confined to the satisfaction of conditions required by the Parliamentary franchise. In accordance with this advice, Parliament provided merely for publication and auditing of the accounts of the companies. These provisions with certain minor alterations (made by the Railway Acts of 1871 and 1889) remain in force to-day.

By these acts, the British railroads are required to keep certain accounts and to furnish half-yearly to the Board of Trade and to their stockholders certain "returns" covering capitalization, traffic, and working expenditures. These returns must be presented in the form of prescribed schedules. They include, in addition to the so-called balance sheet and net income statement, other financial and statistical details, such as the amount and character of the authorized and outstanding capital, the receipts and expenditures on capital account, train and ton mileages and other traffic statistics. The correctness of these statements must be vouched for by the Chairman, Deputy Chairman, and Accountant of the company.

The Railway Companies' Act of 1867 provided also that the published accounts of the companies should bear an auditor's certification. The auditor is to declare that the accounts "contain a full and true statement of the financial condition of the company and that the proposed dividend on any shares is bona fide due thereon after charging the revenue of the period with all expenses which in his judgment ought to be paid thereout." Moreover, "auditors at any time may add to their certificate, or issue to the shareholders independently at the cost of the company, any statement which they think material for the information of the shareholders." These provisions have had a pronounced influence on the prestige and authority of the auditing profession in Great Britain.

Altho the Board of Trade is empowered by the Railway and Canal Act of 1888 to prescribe additional forms of accounts for the railways, and to alter the forms in such manner as may be deemed expedient,¹

¹ Part II, Section 32, of the Railway and Canal Act of 1888

no important action of this sort has been taken. In the forty-two years since regulation began, the character of the railroad business has not only materially changed, but almost every company in Great Britain has undergone alteration in its organization. Companies have amalgamated; sections of line and stations have become the joint property of two or more companies; and in many instances conversions of stock have involved nominal additions to capitalization. Such changes inevitably lead to complications in accounts, and in the absence of any common understanding among the companies as to how they should deal with these in the prescribed schedules, discrepancies are bound to appear.¹ Almost complete freedom is allowed the railways in the method of handling accounts. This freedom is especially noteworthy in the application or disposition of capital raised and money borrowed under Parliamentary authority.

Undoubtedly the Board of Trade relies much upon the auditor's certificate. This certificate, however, as will be pointed out later,² fails to prevent, or at least to exhibit fully and plainly certain abuses and deceptions. Moreover, many writers on railway statistics in Great Britain complain that the policy of non-interference in the accounting methods of the companies and the secrecy maintained regarding important financial matters make it possible for the companies to pay dividends out of capital and otherwise to deceive the public as to their financial standing even tho the auditor's certificate contains the statement that all revenue items are charged to profit and loss. In fact, "to all but a very small percentage of the proprietors of railway stocks, the accounts of the

¹ "Railway Companies' Accounts and Reserves," *London Times*, July 1, 1907.

² See p. 485.

companies as published in the statutory form are a sealed book.”¹

The British Board of Trade in regulating railroad accounts appears to have no object other than the publication of statistical information for the public. There seems to be no desire to obtain data on operating costs or on the net return for actual capital investment. Altho Parliament has gone probably as far as any legislative or administrative body in controlling railroad rates and in regulating traffic, the notion of using railroad accounts in determining just traffic charges has never been prominent. In the voluminous printed proceedings of the Select Parliamentary Committee appointed in 1881 to inquire into railway rates, the relation of accounts to the establishment of just rates was mentioned only once, and then but incidentally and indirectly. The question of publicity of railway accounts for any purpose appears to have given the Select Committee little concern. Mr. James Grierson, then general manager of the Great Western Railway, while testifying before the Committee, was asked whether the railways would be more fairly treated by the public and by Parliament if they were more frank.¹ “A company cannot hide its position,” the witness emphatically stated. “The accounts that are published half-yearly are vouched for by the chairman, the secretary

¹ “London Times,” July 1, 1907 The following extract from W W Wall, “British Railway Finances,” pp 24-25, gives some idea of the liberties allowed the companies in adjusting their accounts to enable the declaration or payment of unwarranted dividends —

“In 1901 the Great Eastern directors took £55,000 from the Contingent Fund, or nearly half the total, in order to enlarge the dividend on the ordinary stock for the half year The South Eastern (for the same year) paid all its preference dividends tho its accounts revealed that there was a shortage of £14,427 therein and that sum was accordingly taken from the Steamboat Depreciation Fund The Great Northern took from its reserve the sum of £60,000, equal to $\frac{1}{2}\%$ on its ordinary capital, in spite of the fact that there is a suspense account in its balance sheet to which the auditors have called attention for years past ”

and the accountant signing them and by the auditors, and, therefore, any person even if he is not a shareholder, is as wise as any shareholder can be.”¹

The reports (returns) of the British railways to the Board of Trade are made half-annually in the form of schedules. Fifteen schedules are prescribed by the Board of Trade. Only a part, however, relate to the accounts, the others dealing with statistics of traffic, mileage, etc. The schedules constituting the principal accounts of the companies, and the respective numbers by which they are designated, are: —

1. Authorized and Issued Capital of the Company.
2. Stock and Share Capital Created, showing proportion paid in.
3. Receipts and Expenditures on Capital Account.
- 9 Revenue Account (*i e.*, Operating Account) being gross receipts and expenditures.
10. Net Revenue Account
11. Appropriation Account, *i e.*, application of the net revenue.
- 13 General Balance Sheet.

Some of these schedules contain particulars which are not generally reported to shareholders and are not as a rule published by the Board of Trade. The statements contained in the half-yearly reports to shareholders follow the forms prescribed, but are limited mainly to earnings for the period and to proposed dividends. The returns include details of certain financial matters, such as the amount of discounts paid or premiums received in the issue of capital obligations, and the amount of subscriptions to the capital of other companies. Tho these particulars are not published in the reports of the Board of Trade, failure to make full report as prescribed subjects the company to heavy fines.

¹ Report of Select Parliamentary Committee of 1881, par. 13843-13846 Cf par. 13460-13461

The prescribed accounts of the British railroads may be conveniently classified into two groups; those relating to Capital and those relating to Revenue. In the reports of American railroads, each group is confined practically to a single comprehensive statement, *i. e.*, the balance sheet exhibiting in condensed form all the assets and liabilities of the company, and the income statement showing gross earnings and expenses as well as the net revenue and its application. According to the method of accounting devised in Great Britain for public service corporations, the receipts and expenditures on capital account are shown separately from the general balance sheet. This feature of British railroad accounts, distinguishing them from those of American companies, is technically known as the "Double Account System." It originated in Section 3 of the Regulation of Railways Act of 1868 and has since been extended to other public service companies, in spite of criticisms and complaints against it. By the "Double Account System," the details of capital expenditures and capital receipts (*i. e.*, capital assets and capital liabilities) are separated from the other assets and liabilities of the company. Only the balance, *i. e.*, the excess of expenditures over receipts or vice versa, enters into the general balance sheet. This system is based on the theory that inasmuch as the capital is created by Parliamentary authority for a specific purpose, the purpose is best fulfilled by crediting to one general account all money received from the issue of capital securities and debiting the account with all the assets acquired with the funds so received.

This separate schedule for the capital account affords a more marked distinction between capital receipts and expenditures and revenue receipts and

expenditures than is ordinarily exhibited in a single balance sheet. The "Double Account" system however is not, as is commonly believed, a distinct system of accounting. The proper distinction between capital and revenue is the fundamental principle of all accounting, and the mere separation of the general balance sheet into sections, the first of which comprises assets and liabilities on capital account, while the second contains the current assets and liabilities along with acquired working capital (*i. e.*, surplus), does not create a separate system of accounting.

From the standpoint of publicity the leading objection to the "Double Account" is that the most important items of fixed assets and liabilities are excluded from the general balance sheet, which contains merely the balance of the capital account. The smaller book balances of debits and credits on the other hand are unduly emphasized through separate itemization. This criticism is based on the conspicuously small number of items in the statutory form of the capital account, which greatly detracts from its value to both the shareholder and the investigator. The liability (*i. e.*, credit) side contains but four items, three of which cover issues of capital securities. The last item, "Sundries," covering premiums, etc., may be more or less detailed as suits the companies. Neither the Share capital (*i. e.*, capital stock) nor the Debentures (*i. e.*, bonds) are classified in the capital account according to character or duration. Moreover, separate items specifying the discounts suffered and premiums received on capital issues are not published, but the published returns include large nominal additions to capital made by the mere conversion, consolidation, and division of stocks. Some of the British railroads have received large sums from the issue of stock at a

premium. The premiums thus received are expended as capital, but, not claiming dividends, they are excluded from the figures representing the "paid up" capital. Had the money been raised by an issue of the stocks at par, however, the amount of stock, and consequently the amount of the total paid-up capital as published, would have been increased by the amount of such premiums.

The so-called nominal additions which are included in the returns as part of the paid-up capital have come for the most part from the conversion, consolidation, and division of stocks. The Midland Railway, for example, in 1897 divided every £100 of its ordinary stock into £100 Preferred Ordinary and £100 Deferred Ordinary, thus doubling its ordinary outstanding capital without receiving one penny in funds. This practice of increasing capitalization by mere book entries is equivalent to the issue of stock at a heavy discount. Since 1889, the nominal additions to capital, tho not published separately from the capital paid in cash, in the statements issued by the companies to their shareholders have been separated in the Board of Trade returns.

Probably the most serious criticism against the statutory form of the capital account of British railways is the carrying of assets therein at cost value from year to year, regardless of depreciation, disuse, or changes in market value. The "Double Account" system does not permit the "writing off" of depreciated and abandoned assets acquired through capital expenditure. Consequently the British railroads, altho at liberty to carry reserves covering depreciation of fixed assets, appear to have openly provided for depreciation charges in only exceptional cases.¹ More-

¹ See W. W. Wall, "British Railway Finance," p. 379; also *Encyclopaedia of Accounting*, vol v, pp 453-454

over, there are no special provisions in British railway accounts for the "writing off" of various useless or abandoned assets. Much of the value carried on the books therefore, covers "dead" property that contributes nothing toward earning capacity.¹ The companies generally retain the original valuation for worthless assets until disposed of in some way, and then the renewals or replacements are met out of new capital issues or out of current revenue, as suits the convenience of the company. Consequently there are serious inequalities in the amounts chargeable to revenue for replacements from year to year. The temptation is always strong during lean years to postpone renewals, replacements, and necessary improvements, or to charge them to capital. The more modern equipment cannot be bought at the original cost of that which it replaces; and when no item represents accrued depreciation on assets in use, — and those assets appear at cost, notwithstanding the fact that they have deteriorated in value, — the cost of maintenance and renewals during later years is bound to be excessively heavy. Partly to this circumstance may be ascribed the heavy operating expenditures of the British railroads, and the corresponding decline in dividend rates, during the last two decades.

Passing from the schedule of the capital account to the statutory form of the general balance sheet (Schedule 13), we find here also much to criticise. The general balance sheet is commonly held to be the most important financial statement of business. As issued by the British railroads in the statutory form,

¹ The only depreciation provision that the British Railways are required by law to maintain is a sinking fund for the replacement of steamboats. Inasmuch as a steamship represents a large unit of investment which goes out of service at one time, it is essential that a fund available in cash be at hand for its replacement.

however, the general balance sheet because of its misleading character, is rarely considered at all by investigators of British railway finance. As an English writer aptly puts it: "It is designed to convey a minimum of information in as incomprehensible a form as possible."¹ The general balance sheet is the only schedule of prescribed railway accounts on which comparison with the figures for the corresponding half year is not provided. "Why this should be so we do not know except it has become a tradition of English railway management to keep shareholders and the public in the dark about every point on which disclosure is not compulsory."²

The main objections to the statutory form of the general balance sheet of the British railways are (1) the lack of sufficient details regarding capital receipts and expenditures and (2) the improper grouping of items. The first two items on the assets side are merely balances transferred from other accounts, viz: the credit balance of the capital account (Schedule 4) and the credit balance of the net revenue account (Schedule 10). These two items are of greatest interest to both shareholders and the public. Yet, as already remarked, the mere exhibition of balances instead of details serves often to delude rather than to enlighten.

As regards the other items in the schedule, it may be said that they do not follow strictly the classification and grouping approved by accountants. The accounts covering subsidiary enterprises or outside operations, which are usually of peculiar interest in the published financial statements of American railroads, may be combined in the schedule with other miscellaneous accounts under one heading "Special

¹ *Investors Review*, August 31, 1901, quoted in W. W. Wall, "British Railway Finance," p. 390.

² *Ibid*

Items." Consequently the extent of the outside operations of companies can be readily hidden even from shareholders. Tho there is a separate item for general insurance provisions and also "Insurance Fund on Steamboats" — which, as has been already pointed out, is the only depreciation reserve account required by the statutes, — a number of the British companies which carry general reserves, as well as reserve funds for purposes other than required by law, sometimes hide these as "Sundry Accounts Receivable"; for stockholders frequently object to the creation and maintenance of reserves at the expense of dividends.¹

The revenue accounts, or income statements, are the most satisfactory of the schedules prescribed. The receipts are classified according to the leading sources of railroad revenue, the classification being very similar to that followed in the United States. The receipts from freight and from passenger traffic, and the income derived from the express and postal transmission business, are clearly separated. The receipts from outside operations, such as rents, hotels, docks, canals, etc., are also detailed separately. The expenses of operation are itemized in a manner suitable for statistical use. Expenditures for the maintenance of steamboat service, harbors, docks, canals, as well as for other extraneous operations, are shown separately, but no endeavor is made to offset against the expenses of these operations the income obtained from them; hence one cannot learn the net gain or loss therefrom.²

¹ In spite of the stockholders' objections a few companies openly maintain reserves by regular periodical charges to revenue, and a number of others have built up reserves with funds derived from extraneous sources

² According to the system of accounting for railroads adopted by the Interstate Commerce Commission, the revenue division of each account for outside operation is

Prompted by the severe criticisms of the prescribed forms of railroad accounts the Board of Trade on June 15, 1906, appointed a special committee "to consider and report what changes, if any, are desirable in the form and scope of the Accounts and Statistical Returns rendered by Railroad Companies under the Railway Regulation Acts." After holding 67 meetings for deliberations and hearings, this committee finally reported in May, 1909.¹ The part of the report dealing with accounts recommends, in addition to new forms designed for the improvement and amplification of financial returns, (1) a strict division between the financial and statistical parts of the returns of the railroads, and (2) a separation of the accounts of the railroads from the accounts of their subsidiary enterprises. The committee also favored annual instead of semi-annual returns to the Board of Trade and a uniform date for closing the fiscal year. It urged that the manufacturing and maintenance expenditures be shown as separate items in both the capital and the revenue accounts, so that the actual outlay in maintaining terminals, roadway, and the various classes of equipment of each individual company will be shown. The accounting reforms recommended are, in general, very similar to those already established in the United States and are in line with the policy of wider publicity.

The chief criticism against the present accounting methods of the British railroads is that they frequently

credited with all revenue applicable to that particular operation, and the expense division of each such account is charged with the cost of operating and maintaining the property employed in it, including cost of supervision and taxes. This system has been recommended for adoption in Great Britain by a special committee of the Board of Trade

¹ Accounts and Statistical Returns Rendered by Railway Companies:— Report of the Committee appointed by the Board of Trade (1909) Cd 4697.

neglect to distinguish properly between capital expenditure and revenue expenditure. As President Hadley has pointed out:—

“It is impossible to avoid a suspicion, which the secrecy of English railroad accounts prevents us from proving or disproving, that certain leading English railway companies have been in past years paying dividends out of capital, dividing as large a proportion of gross earnings as possible, swelling the construction account unfairly and borrowing money for expenses which should have been paid out of revenue.”¹

The rapid increase in the capitalization of British railroads seems to bear out this statement. During the thirty years between 1870 and 1900, the capital of the British railroads almost doubled, whereas the length of line in operation grew only from 15,376 miles in 1871 to 22,078 miles in 1901. These figures, it is true, represent geographical miles and not track miles, and hence are not a fair criterion of over-capitalization.² But even taking the track mile as the basis, the capitalization of the British railroads (exclusive of the “nominal additions”) when compared with the capitalization of the American companies is at a high level. This arises largely from the general British practice of charging all improvements and betterments to capital, regardless of the effect on earning capacity. It is a common opinion that railway shareholders are entitled at the end of each half year to whatever profit has been earned during the period, and that it is unfair to use that profit as working capital for the benefit of future shareholders.³ This opinion, however, is not shared by all writers

¹ Hadley, *Railroad Transportation*, p. 155.

² See Ross, *British Railways*, pp 221–222 See also W M Acworth, *The Position of the English Railways*, *North American Review*, September, 1909.

³ A writer in the *London Times*, July 1, 1907, signing himself “A Railway Correspondent” goes so far as to say that a railway company charging “improvements to revenue instead of capital is ‘ultra vires’”

on British railway finance, tho it seems to prevail in actual practice. Mr. Hugh Monroe Ross, while defending the British companies against the criticism of excessive capitalization, remarks:—

“In Great Britain both principle and practice have been less heroic than the most advanced American theory and undoubtedly there has been a tendency to call upon capital rather than revenue to bear the cost of such betterments as replacing old bridges with new and stronger ones or rebuilding and enlarging passenger stations or goods depots. But it would not be true to say that it is the universal practice.”¹

It is seldom possible to ascertain from the published accounts of the British railways how improvements and betterments are dealt with. Some companies in a strong financial position allow revenue to bear some of the cost of betterment, while others less favored charge every item they can to capital, and sometimes even fail to make proper provisions for renewals. So long as the statutory form of accounts fails, as we have already shown, to require any distinction to be made between repairs and renewals, and to require specific provision for depreciation, it will continue to be exceedingly difficult to learn the facts.

The British railways work upon the theory of charging revenue with only the amount necessary to keep the line at its original efficiency. Practically all additions to rolling stock, and all kinds of extensions and betterments, are charged to capital. After that, the profits are divided up to the hilt among the bondholders and shareholders. British railroads, for example, treat the cost of widening existing lines as a capital charge whether or not the widening is done to increase earning capacity. The expense of installing safety devices and other improvements required by law has been made a capital charge. The Act of

¹ British Railways, p 227.

Parliament of 1889, requiring automatic brakes and the block system, specifically authorized bond issues to carry out its provisions. The Board of Trade exercises little supervision over the application of capital raised under Parliamentary authority.

As a result of the policy of charging betterments to capital instead of to revenue, the capitalization of the British railroads, inclusive of nominal additions, stood at the end of 1907¹ at £396,593,636 more than in 1890, altho the increase in line was but 3,035 miles. This increase is more serious than at first appears, for with some unimportant exceptions all the capital was raised by irredeemable and perpetual stock. According to Mr. J. Russell Sowray, who claims to have examined between forty and fifty of the half-yearly accounts of the leading companies, about 38 per cent of the railroad capital expended during the last five or six years was incurred on lines already open for traffic. That this practice is entailing a heavy burden of fixed charges on the railroads is shown in the following table giving the increase of capital, the increased annual charge (assuming that the capital was raised at $3\frac{1}{4}$ per cent, and the growth in traffic receipts for the two eight-year periods 1890–1898 and 1898–1906²: —

Period	Increase of capital ³	Increase of annual charge ⁴	Increase in net traffic receipts	Excess of annual charge
1890–1898	£110,507,521	£3,591,494	£3,531,812	£59,682
1898–1906	140,642,375	4,570,877	4,154,119	416,758
1890–1906	£251,149,899	£8,162,371	£7,685,931	£476,440

¹ Returns, 1907, p. xx. The increase in double track or more is 1,856 miles.

² See J. Russell Sowray, *British Railway Finance*, p. 16.

³ Excludes nominal additions; hence the discrepancy with the figure given on the preceding page.

⁴ Assuming that capital was raised at $3\frac{1}{4}$ %.

The practice of the British railroad companies in charging heavy expenditures for improvements, etc., to capital, however, seems to have become less pronounced in late years.¹ Improvement is also shown in other lines of financial administration. There is less hesitation in frankly setting aside profits for the formation of reserves, showing a lessening hold of the dangerous belief that shareholders are entitled to the full profits as they accrue and that no provision for the future at the expense of the present will be tolerated.

FRANCE

The railroad policy of France follows the theory that the railroads should be operated and managed by strong independent companies supported by government funds and conducted under strict government control. The companies are not allowed to compete with one another, and tho they are encouraged to earn large profits, they are required, when their earnings exceed a certain maximum based on their capitalization, to share the surplus with the state. The French government is virtually a partner, inactive but supervisory, in railway enterprise. It initiates, supports, and controls the construction and operation of the lines, but with the use of private capital and under private management.

The financial measures adopted in France for the encouragement and support of railroad construction included both guarantee of interest payments on capital obligations, and guarantee of a minimum return to shareholders.

The principle of the guarantees was originally based on the hypothesis of a temporary deficit in revenue

¹ See Stevens, *British Railway Outlook*, pp 16-17.

arising from the extension of lines into less profitable territory. The guarantee was therefore limited to a definite term of years.

The close financial bonds existing between the railroad companies and the French government were first established by the so-called "Conventions of 1859," which provided for the reorganization of lines controlled by the six great companies, creating in each a new 'network' known as the "Nouveau Réseau." The "Conventions" were drawn up in order to permit the government to complete its system of railroads with the use of private capital, thus avoiding a heavy burden on the national budget. When the new and less remunerative lines were planned, it became necessary to utilize both the experience and the credit of the companies operating the old lines. This was accomplished by saddling the old lines with a large share of the expense of constructing and opening the new lines. To compensate them for this burden, the government guaranteed them against loss on the capital employed for this purpose. Each company joining the plan received a guarantee of interest at 4 per cent for a period of fifty years, and amortization at the same rate on the capital employed.

The importance of the Conventions of 1859, from the standpoint of the publicity of railroad accounts, lies in the supervision and control thus acquired by the French government. This resulted in regulations which, tho altered and amplified somewhat by later conventions and by special decrees, are essentially in force at the present time.

The principal railroad accounts prescribed by the French government for the six great companies may be conveniently grouped as: (1) The capital accounts, consisting of (a) the "construction account" (*Compte*

de Premier Établissement) and (b) the "equipment account" (*Compte de Travaux Complémentaires*); (2) The income or operating accounts (*Compte d'Exploitation*); (3) The appropriation or net revenue accounts (*Le Compte de Garantie et Partage*). These and other less important and subsidiary accounts are submitted periodically to the Minister of Public Works.

In addition to the accounts drawn from their books and records, the companies, in conformity to an administrative order issued by the Minister of Public Works, February 28, 1888, report during the first days of October each year a general budget (*i. e.*, estimate), for the following year, of their receipts and expenditures for operation; the expenditures on capital account for construction (*travaux de construction*); and the expenditures on capital account for equipment, rolling stock, etc. These budgets are uniform for all companies. Before they are submitted to the Minister of Public Works they are examined and approved by the consultative committee attached to each company.¹

The principal accounts are discussed in order below.

1a. *Construction Account (Compte de Premier Établissement)*: — Unlike the British government, the French government strictly defines and supervises the capital expenditures of the railroads. The administrative decrees following the Conventions of 1859 clearly stipulated that expenditures for the following purposes only can be charged to the construction account: —

(1) Expenses entering into and leading up to the construction of each line and its branches to January 1st following the opening of the line for traffic.

¹ M. Antoine Filippini, *Contrôle de l'État sur la Gestion Financière des Compagnies de Chemins de Fer*, p. 95

(2) The net operating and maintenance expenses during the period of construction for the constructed portions of an uncompleted line.

(3) Payments during the period of construction for interest and amortization on the capital obligations issued for the purpose of constructing the line. When the road is opened to traffic the guarantee of interest payment for the line begins.

In addition to these capital charges, the companies, after the Conventions of 1883, were authorized to charge to construction expense the deficits accruing from the operation of completed lines in a new system to January 1st following the completion of the system. This regulation entailed a new account, called the *Compte d'Exploitation Partielle*. At the time the new account was authorized, it was estimated that about ten years would be required to complete the new lines. It was soon found, however, that the time would be much longer. Meanwhile, the constant piling up of deficits was carrying the construction accounts to enormous figures, and entailing increasingly heavy interest charges on the government. The companies, during the years 1890-1892, were accordingly induced to consent to a modification of the *Compte d'Exploitation Partielle*.

At the present time, the construction account for each separate line is provisionally closed on January 1st following the opening of the line for traffic. Thereafter, during a period of five years, certain minor expenses and charges essential for the final completion of construction and for operation may be added to the general construction account. These charges are called *Dépenses de parachevement*.¹ Even after the five years have elapsed, permission may be given

¹ Filippini, op. cit., p. 68.

by the administrative authorities to add to the construction account expenditures for the execution and completion of works recognized as proper charges to construction.

1b. *General Equipment Account (Compte de Travaux Complémentaires)*: — The general equipment account of the French railroads is charged with all expenditures for operating equipment, materials, rolling stock, etc. This is generally opened after the "Construction Account" is closed. The maximum amount to be expended each year as a charge to this account is authorized for each company by the Minister of Public Works (the total for all companies being passed upon by the Parliament). If a company expends more than is authorized, the excess must be charged to current revenue in the same manner as repairs, renewals, replacements, etc.

The principal motive for limiting the expenditures of the companies for additional equipment, etc., is the fear of aggravating the burden of guaranteed interest through excessive and continuous charges to capital. The extent of the additions to capital through charges to the *Compte de Travaux Complémentaires* is indicated by the fact that for the year 1908 the Minister of Public Works authorized expenditures for rolling stock to the amount of fr. 426,715,000 and for other equipment fr. 383,000,000; a total of fr. 809,715,000.¹

¹ Guyot, *La Crise de Transports*, p. 61

An *arrêté du Conseil d'État*, June 15, 1877, established the following rule regarding the charging of the cost of new equipment to capital —

That when new equipment is purchased to replace old equipment only the excess of the cost of the former over the latter can be made a charge against capital. When the old equipment is abandoned and not replaced, the book value thereof is charged to income, and if new equipment is purchased at a less cost than the equipment replaced, the capital account is reduced by the amount of the difference in cost and the income charged with the resulting loss. See Picard, *Traité de Chemins de Fer*, vol. II, p. 468.

In spite of the well defined rules for determining capital charges, frequent disputes between the companies and the administrative authorities have arisen over two important matters in railroad accounting, (1) The treatment of abandoned and unemployed property, and (2) charges for the cost of temporary construction and equipment. For obsolete and abandoned property, the principle generally prevails of crediting the cost to capital through a charge to revenue.¹ Temporary equipment both the companies and the government generally agree should be paid for out of the revenue of the period during which such construction or equipment is in use. The government now requires all provisionary and experimental construction to be carried to a suspense account. If the construction is abandoned, the cost is charged to revenue, but if maintained and used permanently, it becomes a capital charge.

The capital obligations created by the companies also command the closest supervision and attention on the part of the administrative authorities. Each company is required to report to the Minister of Public Works and to the Minister of Finance before the sixth of each month a detailed statement of its bond and stock issues of the preceding month and the total issued since the first of the year.

2. *The Revenue Accounts (Comptes d'Exploitation)* are regulated and supervised in the same manner as the capital accounts. The statutory classification of receipts and expenditures does not differ essentially from that in Great Britain and in the United States. In the matter of operating expense, however, the French government exercises close vigilance. A company is required to charge as operating expense: (1)

¹ See Filippini, op cit, pp 106-112

All expenditures, dating from January 1st following the opening of each line, for ordinary and extraordinary repairs, replacements, and the costs of administration, etc., but excluding such of these expenditures as the company is permitted or required to charge to capital; (2) Taxes; (3) The cost of maintaining landed properties up to the time of alienation; (4) Amounts set aside for reserves required or permitted by law; and (5) Amounts set aside for the benefit of employees. Specifically excluded from the expenses of operation are: (1) Interest and amortization charges on capital loans, including the interest charges on loans covering the excess of authorized capital expended on construction, and (2) Extraneous expenditures, *i. e.*, expenditures not pertaining to the operation of the railroad.

When replacements consist of equipment of a more efficient and more expensive type than that replaced, the excess of the cost of the new over the old is charged to capital and the remainder to revenue. The excess when not known definitely may be estimated. The companies are required to maintain their equipment in good condition and to keep an adequate supply of operating supplies and materials on hand.¹

After the net earnings of each company have been determined and the fixed charges, such as interest and amortization, deducted, the account is submitted to the Minister of Public Works. This official examines the reports thereon by the official auditors and, with the advice of the Minister of Finance, determines what changes and adjustments are to be made. If there is a deficiency of net revenue, he decides what

¹ According to the *cahiers de charges* imposed on the companies, they are to have on hand at the expiration of their concessions a stock of materials and supplies ("ap-provisionnements") sufficient for six months operation of the road. Filippini, *op. cit.*, p. 108

amount the government is to advance under the guarantee of interest, and if there is a surplus what the government is to receive under its right of participation in profits. A company considering itself injured by the official revision of the accounts has recourse to the Council of State.

The railway companies in France have separate accounts for the real and personal property in which their undivided profits are invested as "private domain" (*domaine privé*). The revenue from this surplus is free from the liens of the State, and the companies have the privilege of increasing dividends from this source without interference. The Government, however, has the right to examine and verify the correctness of the *domaine privé*. In this auditing process considerable conflict with railroad officials results. The official inspectors are accused at times of seeking to transfer certain charges against operating revenue or even against capital to the debit of this undivided profit.¹

The Conventions of 1859 provided that the accounts must be submitted for examination to a commission appointed for each company by the Minister of Public Works. This commission was composed originally of a *Conseiller d'État*, who acted as president, and six members, three of whom were chosen by the Minister of Finance.² With the co-operation of government auditors, each commission was empowered to audit every account of the railroad company to which it was attached. In 1883 these *commissions de vérification* were replaced by one central commission, working

¹ See Filippini, *op cit.*, pp 74-75, 104

² Kauffmann, *Chemins de Fer, etc* , p 400.

under the direction of the Inspector General of Finances. Its auditors (*inspecteurs des finances*) examine in detail the accounts of the companies both at the head office and at the stations. The officials of the companies are required to respond to all inquiries made to them by the inspectors. If discrepancy is noted by the inspector and is acknowledged by the officials of the company, the matter is officially corrected. If there is disagreement, the matter is brought before the central auditing commission through the Inspector General of Finances. The company may appeal from the decision of the auditing commission to the Council of State.¹

As a means of preventive control over the operations of the companies, consultative committees work in co-operation with each company under the direction of the Minister of Public Works. Each committee is presided over by an inspector general of ways and structures, who assembles the committee at least once a month. The propositions of the company, as well as the demands of the Minister of Public Works, are submitted to this committee for consultation and approval. The committee deliberates on the company's annual budget and reports periodically to the Minister of Public Works the financial results of its operations.²

To summarize, every financial activity of the French companies is subject to minute inspection and control. Regulations are prescribed regarding all the principal accounts, especially those relating to operation, to the payment of interest, to the distribution of surplus,

¹ Filippini, *op. cit.*, pp. 67, 71

² See Kauffmann, *op. cit.*, p. 401. The presidents of the chambers of commerce of the towns through which the lines of the company pass may attend the meetings of the consultative committee.

to capital investment; and also regarding such purely financial operations as the issue of capital stock and bonds, the amortization and redemption of capital securities, and the temporary investment of surplus funds.

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